No. 9746.

IN THE

United States Circuit Court of Appeals

FOR THE NINTH CIRCUIT

UNITED STATES OF AMERICA,

Appellant.

vs.

J. LESLIE MORRIS COMPANY, INC., a corporation,

Appellee.

BRIEF FOR THE UNITED STATES.

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Opinion Below.

The memorandum opinion of the District Court [R. 32-36] is unreported.

Jurisdiction.

This is an appeal from a judgment of the District Court entered August 21, 1940 [R. 61-62], in favor of appellee for the refund of $1,500 assessed and paid as manufacturer's excise taxes. Notice of appeal was filed November 19, 1940. [R. 62-63.] Orders extending the time for filing and docketing the record on appeal were duly obtained. [R. 63-64.] The jurisdiction of this Court is invoked under Section 128 of the Judicial Code, as amended February 13, 1925.

Question Presented.

Whether sales of automobile connecting rods by appellee were taxable under Section 606(c) of the Revenue Act of 1932, which imposed a tax upon automobile parts "sold by the manufacturer, producer, or importer" thereof.

Statute and Regulations Involved.

These are set forth in the Appendix, *infra,* pp. 1-2.

Statement.

The case was tried to the court without a jury upon evidence consisting of the testimony of two witnesses offered by appellee and numerous exhibits offered by each of the parties. The court rendered a memorandum opinion [R. 32-36] and filed findings of fact and conclusions of law [R. 36-60] in favor of appellee. The facts, as disclosed by the undisputed evidence, may be summarized as follows:

Appellee was incorporated in 1925 [R. 77], under the laws of California to "operate a business for the manufacture, sale and distribution of automotive and industrial bearing metals and products" and to "operate branch plants and offices in the State of California and elsewhere for the manufacture, sale and distribution of such metals and products." [R. 37.] Its principal place of business was in Los Angeles. [R. 37.] During the taxable period, it was engaged in producing [Pltf's Ex. 49] and selling [R. 39, 45, 59] automobile connecting rods, under the copyrighted trade name "Moroloy" [Pltf's Ex. 49; R. 193, 218], throughout the United States to wholesalers, known also as jobbers [R. 79, 102, 172] on the exchange basis

of sale [Pltf's Ex. 49; R. 84, 197], for replacement [R. 177] purposes in connection with the repairing of automobile motors by garage men and mechanics [R. 83, 85].

A connecting rod is the means of transmitting energy created by the explosion of gas and air in the cylinder in the piston head, to the crank shaft. It connects the piston (by being attached to the crank pin) to the crank shaft. [R. 89.] There is a babbitt bearing (known as the crank shaft bearing) in the large end of the connecting rod. [Pltf's Ex. 34.] The babbitt bearing is within the parts of the rod known as the cap and shank which are held together by two bolts and nuts. [R. 108.] The smaller end of all rods is known as the wrist pin end. At least half of the rods produced by appellee during the taxable period had bronze bushings in the smaller end of the shank [Plft's Ex. 26], such as in the case of Ford rods [Pltf's Ex. 31], and some of the rods were of the type which required shims [R. 174-175].

Appellee owned and operated plants or factories in Los Angeles, New York, Chicago, Columbus, Portland, and Seattle, for the carrying on of its connecting rod operations and sales [R. 163, 239, 241] and was affiliated with various other plants throughout the United States and Canada which it did not own [R. 43-44, 189, 192-193]. One of the affiliated plants is at 2354 Valley Street, Oakland, California.[1] [R. 189, 194.] The Oakland plant pays appellee a monthly royalty of 2% on its operations. [R. 194.] Appellee handled its customers in exactly the same way as did the Federal Mogul Corporation and auto-

[1]This is the Moroloy Bearing Service of Oakland, Ltd., which is appellee in a similar case now pending in this Court on the Government's appeal, No. 9786.

mobile manufacturers who engaged in similar business on the exchange basis of sale for automobile replacement parts. [R. 197.]

This case is concerned only with sales by appellee of automobile connecting rods during the period June 21, 1932, to August 21, 1935. [R. 39, 45, 59.] It involves appellee's stock of connecting rods produced from a combination of new and used materials and sold to jobbers on the exchange basis of sale for use by garage men and mechanics in repairing automobiles. [Pltf's Exs. 1-32; R. 84, 197, 242.]

At Los Angeles, appellee had 12 to 14 persons engaged in its production processes, including shipping and receiving. [R. 168.] There were about 20 employees in the shop and office, together. [R. 167.] It employed about 18 persons at its Chicago plant and fewer persons at the four remaining plants. [R. 168.] It did not employ salesmen directly but did on a commission basis. [R. 171.] The latter represented three or four different automotive people and would sell to wholesalers. [R. 171.] Since the taxable period, appellee has conducted part of its sales through warehouses on consignment in various cities where it has no plants.

In its operations, appellee uses divers pieces of equipment, tools and machinery, including among other things lathes, drill presses, arbor presses, milling machines, grooving machines, hydraulic broaching machines, specially built centrifugal casting machines, molds, slotting tools, circular saws, cutting tools, babbitt pots, grinding wheels and chamfering tools. [R. 40, 42, 43; Pltf's Exs. 1 to 32.]

At its Los Angeles plant appellee produced about 400 rods a day. [R. 170.] Its Chicago plant produced about the same number. [R. 164.] The Moroloy rods followed the same line of operations as did rods comprised of entirely new materials, so far as appellee's operations were concerned. [R. 218.]

In connection with its processes, appellee purchased and used new babbitt metal (consisting of tin, copper and antimony), new shims, new nuts, new bolts and new bronze bushings. [R. 138, 174, 197, 199, 214, 221, 223.] It also used solutions of hydrochloric acid, oakite and rust preventives. [Pltf's Exs. 8, 14 and 20.] The used shanks and caps, known also as forgings, which were utilized in its processes either were purchased by appellee from people who made it their business to obtain them from wrecked cars for the purpose of reselling them to appellee and others engaged in similar business [R. 175, 183], or were obtained by appellee from its jobbing customers who turned them in on their purchases from appellee of completed rods of similar type on what is known in the trade as the exchange basis of sale for replacement parts [R. 119-121, 196-197; Pltf's Ex. 49].

Appellee maintained a stock of hundreds of different types of connecting rods and assigned to each a stock number of its own, such as Stock No. 525, Stock No. 526, etc., covering nearly all makes of automobiles. [Pltf's Ex. 49; R. 242.] Appellee's connecting rods were known by and sold to the trade under appellee's own stock numbers and copyrighted trade name "Moroloy." [Pltf's Ex. 49.] The connecting rods sold by appellee functioned just as efficiently as a rod of original manufacture. [R. 218.] The rods were sold in appellee's own boxes, which con-

tained its stock number which conformed to the number in appellee's catalogs and price lists. [R. 128-129, 144-146.] Appellee guaranteed its product against defective workmanship and material in the same manner as did others in the industry. [R. 179.] If someone ordered a rod which appellee did not have in stock, appellee purchased either an entirely new rod or one comprised of both new and used materials from a nearby dealer or distributor for the purpose of filling the order. This occurred only now and then with respect to the latest models. [R. 104.]

The following is a summary of appellee's processes and operations which culminated in the production of Moroloy connecting rods from a combination of used forgings of dismantled connecting rods and new materials:

Automobile wrecking brokers[2] [R. 104, 175; Pltf's Ex. 43, R. 124-126] and jobbers were appellee's source of supply for the used forgings [R. 106, 196-197]. A very few were received from automobile dealers. [Pltf's Ex. 1.] They were received by appellee in lots averaging from twenty to sixty rods per package and were brought either by the shippers' own delivery service, by parcel post, trucking companies, or other delivery services. [Pltf's Ex. 1.] About half of the babbitt bearing of the average used rod was burned off or worn away when received by appellee. [R. 200.] Half of the used rods had bronze bushings at their smaller end and these, too, were worn when they were received. [R. 223; Pltf's Ex. 26.] Both the bronze bushing and the babbitt bearing are bearings and it is necessary in order for a rod properly to perform its function that the bushing, as well as the babbitt bearing, be in first-class shape. [R. 223-224.]

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[2]Automobile wreckers are known in the trade as "junkies."

Upon arrival, the used rods were checked against the shipper's invoice and the boxes in which shipped and any accompanying identification tags were discarded. [Pltf's Ex. 2.] If any of the rods were cracked, bent, or broken, appellee would not accept them but would return them to the sender. [R. 107.] The shank and cap had to be in good condition. [R. 107.] The used rods were segregated according to their respective sizes or types and the thin type bronze pin bushings were removed by means of a cold chisel and hammer [Pltf's Ex. 3], whereas the heavier type of bushings was removed on an arbor press [Pltf's Ex. 4]. The two nuts and two bolts which fastened the cap to the shank of each rod were removed. A power driven socket wrench was used to remove the nuts. [Pltf's Ex. 5.] The nuts and bolts which were in good condition were thrown into a box for later use. [R. 173.] No effort whatsoever was made to keep the nuts and bolts separated so that thereafter they could be placed back on the identical rod forging. [R. 173.] Auxiliary bolts and nuts, which previously had been dipped in solder, then were placed temporarily on the rods for the purpose of subsequent operations. Otherwise, the salvaged nuts and bolts would become immersed in solder during the centrifugal casting operations and it was desired that the appearance of the completed Moroloy rod should resemble as nearly as possible the original condition. [Pltf's Ex. 5.] Both loosening and tightening of all nuts and bolts were accomplished by means of a power driven socket wrench.

Two operations were involved in removal of the used babbitt bearing. The babbitt bearing end of the rod was placed in a pot of molten babbitt of low temperature pre-

pared each day by lighting a gas oven at five o'clock in the morning in preparation for the day's run. [Pltf's Ex. 6.] Such of the babbitt as was removed by placing the unit in the low temperature pot was salvaged for the purpose, subsequently, of mixing it with newly purchased babbitt in proportions of half and half. [R. 200; Pltf's Ex. 6.] The analysis of the old babbitt, thus salvaged, was exactly the same as that of the new babbitt. [R. 200.] After most of the babbitt was removed by the first operation, the remaining babbitt clinging to the large opening in the cap and shank was removed by dipping the large end of the forging into pots containing a solution of molten babbitt of a higher temperature. [Pltf's Ex. 6.] The reason for removal of the babbitt by two operations was that the babbitt in the low temperature receptacle could be used again while the babbitt subjected to the higher temperature became spoiled for further use. [Pltf's Ex. 6.]

After removal of all babbitt, the large end of the rod was cleaned by dipping it into a vat containing a solution of hydrochloric acid. [Pltf's Ex. 8.] Then a flux was applied to the large end of the rod by dipping it into molten tin or solder which served thereafter as a bond and caused the new babbitt metal to stick to the steel forging so as to become a part thereof. [Pltf's Ex. 8.]

Then the nuts were removed from the bolts holding the cap to the shank and by means of a sharp blow the cap itself was removed and two steel separators were inserted between the cap and shank, one on each side. [Pltf's Ex. 9.] These separators prevented the rod and cap from casting together when the molten babbitt thereafter was poured. A power driven socket wrench was used both for removing and tightening the nuts in connection with

the insertion of the separators. [Pltf's Ex. 9.][3] The oil holes in the large end of the forging were caulked with asbestos wicking, or other stoppers, to prevent the babbitt from plugging up the oil holes during the subsequent babbitt casting operation. [Pltf's Ex. 10.]

The forgings then were taken to the centrifugal casting machines specially built by appellee for its own use. One operator could run two of these machines because it took the babbitt about 15 seconds to cast. [Pltf's Ex. 11.] Each machine had a revolving shaft on which was mounted a mold holder which was opened by means of a foot lever. [Pltf's Ex. 11.] The large end of the rod forging was placed between molds which cupped over each side thereof. The mold holder was encased in a pan-caked shaped container mounted perpendicularly to the floor. [Pltf's Ex. 12.] The center of the door to the container had an aperture through which a small trough was affixed. The end of the trough led down into the outer face of the mold which was open. After the rod forging had been set in the mold holder, as stated above, the door of the container was closed and, by means of a foot lever, the shaft and mold started to revolve spinning the rod with the large bearing end of an axis. [Pltf's Ex. 12.] As the shaft, mold and rod revolved, an operator poured molten babbitt into the trough. The babbitt would run down into the large bearing end of the rod and the centrifugal force caused the molten babbitt to spread evenly

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[3]Exhibit 9 states that in the case of rods for Model A Ford engines the cap is cast to the bearing end of the rod. This is obviously an error because the cap and shank must be severable in order to attach or detach the rod to the crank shaft. However, Exhibit 24 states that the babbitt is cast in Ford A connecting rods without the use of separator shims, but the babbitt is thereafter cut through the center so as to free the cap from the shank.

against the inside circular surface. [Pltf's Ex. 12.] Appellee babbitted about 20% of the rod forgings by a hand-casting operation. [Pltf's Ex. 13.] A man would dip the rods in the acid and tin. Then the cap and shank were put separately into a fixture with the proper sized mold, between which mold and the cap on the one hand, and the mold and the shank on the other, an operator poured molten babbitt metal. [Pltf's Ex. 13.] The parts then were removed from the fixture and the surface babbitt protruding as a result of the hand operation was chipped off. [Pltf's Ex. 13.]

Thereafter, a number of rods were placed in a basket which was lowered into a tank containing oakite where they were cleaned. [Pltf's Ex. 14.] All auxiliary nuts and bolts previously inserted together with steel separator shims then were removed. [Pltf's Ex. 15.] All ragged edges of the newly cast babbitt at the point where the separator shims had separated the cap from the shank were removed by holding the open face of the cap, or the shank, as the case may be, against a revolving sandpaper disk. [Pltf's Ex. 16.] The cap then was placed on the rod and either new nuts and bolts, or salvaged nuts and bolts which had been commingled, were inserted for the purpose of clamping the cap to the arm or shank and were tightened by a power driven socket wrench. [Pltf's Ex. 17; R. 173, 214.]

In assembling the cap and shank, two new metal shims were inserted, one on each side, if it was the type of rod which required a shim. Only new shims were used by appellee. [R. 174, 199; Pltf's Ex. 49.]

The operator then cleaned out the oil holes wherever they occurred in each of the units by using a drill press.

[Pltf's Ex. 18.] Because all oil holes were not of the same size, a second drill press with a larger drill also was used to perform the same operation, thus removing the necessity for frequently changing drills. [Pltf's Ex. 19.]

The rods, in groups, then were dipped in a tank containing a solution of rust preventative and thereafter hung on a rack to dry. [Pltf's Ex. 20.] After the drying process, each unit was placed in a lathe where the newly cast babbitt was subjected to three operations. It was bored, faced and chamfered. The latter two operations finished the babbitt to standard width. [Pltf's Ex. 21.] If special undersizes were required the babbitt would be finished on a lathe to the desired undersize. [Pltf's Ex. 22.]

Approximately 50% of the connecting rods have oil pockets in their babbitt bearings. Consequently, appellee subjected the babbitt portion of the rod to an operation on a hand milling machine whereby the necessary oil pockets, or grooves, were cut. [Pltf's Ex. 23.]

All Model A Ford and six cylinder Chevrolet connecting rods required an oil groove on the face of the babbitt bearing which was cut in the shape of a figure eight by a hand operated oil groover. [Pltf's Ex. 28.] Certain Pontiac models required a continuous oil groove around the center of the babbit bearing. [Pltf's Ex. 29.] This groove was cut by what was known as a center oil groover operated by an electric motor. [Pltf's Ex. 29.]

On rods for Model A Ford engines in which the babbitt was cast without the use of separator shims, it was necessary to cut the babbitt through the center in order to sever the cap from the shank. [Pltf's Ex. 24.] This

operation was performed with the aid of a slotting tool and rotating saw. The application of the slotting tool resulted in leaving a groove which would serve to facilitate lubrication. [Pltf's Ex. 24.] After being grooved, the Model A rods were placed on a saw table where a rotating saw blade completely severed the babbitt flange and the cap and shank became separate units. [Pltf's Ex. 25.]

The next operation was to install new bushings in the smaller end of the shank through the medium of a hand-operated arbor press. [Pltf's Ex. 26.] Model A Ford connecting rods were fitted with a very thin bushing which would become somewhat damaged when pressed in by the arbor press. [Pltf's Ex. 31.] This was corrected by placing the rods in a bench drill press and using a chamfering tool. [Pltf's Ex. 31.] The Ford rods required a further operation of grooving or severing on the inside of the bronze bushing. Half of the rods were of the type that required the facing of the outer edge of the babbitt flange by means of a special tool placed in a drill press. [Pltf's Ex. 27.]

Thereafter, all babbitt bearings excepting only those which were finished to special undersizes were finished to final size by an hydraulically operated broaching machine. The machine had a number of horizontal cutters, each removing about .0005 of an inch as the tool was forced through the babbitt bearing opening by hydraulic pressure. [Pltf's Ex. 30.] All bearings then were given a final inspection and the nuts holding the connecting rod caps

in place were loosened by a power operated socket wrench, to enable the operator to ascertain whether or not the threads of the bolts had been stripped. [Pltf's Ex. 32.] New nuts and bolts were replaced where necessary. [Pltf's Ex. 43.]

Each rod then was put in a cardboard carton and placed in appellee's stock room. It had a stock room with stock in it in connection with each of its six plants. [R. 104, 105, 242.] Appellee guaranteed its finished product against defective workmanship and material. [R. 179.] This is a characteristic guarantee in the industry. [R. 179.] Each carton containing a Moroloy connecting rod had appellee's trade name and stock number at one end. The number conformed to appellee's printed price sheets and catalogs. [R. 144; Pltf's Exs. 44, 45, 47, 49.] The label on the end of the carton also contained a picture of a connecting rod and the words "Rebabbitted Connecting Rods, Centrifugally Cast, Accurately Machined" and "Moroloy bearing service".

When appellee found it necessary to obtain a so-called "rebabbitted" rod from a local dealer, appellee had to pay the same price as it would for a "new" one [R. 179]; that is, appellee paid its own retail list price (outright price) which was just about the same for the complete unit as the retail price of new rods taken out of stock which had come from an automobile factory. [R. 251.] If appellee found it necessary to obtain an entirely "new" rod from a local dealer, it sold it to its customers on the exchange basis for the same price as it would its own rods

which it had processed by combining used forgings with new materials. [R. 104-105.]

The following occurred between appellee's chief witness, J. Leslie Morris, and the court [R. 106]:

> The Court: The other ninety-five per cent [of appellee's monthly sales] would consist of taking the used and damaged rod and processing it, as you have described, and delivering that identical rod so processed back to your customer?
>
> The Witness: No, sir; not the identical rod; a rod exactly like it.
>
> The Court: That is what I am talking about.
>
> The Witness: Yes. Not the identical rod, but a rod exactly like it.

The witness further testified [R. 120]:

> * * * it would be physically impossible for us to tell who they came from, except we have the others waiting in the stockroom to go out.

On the side margin of each page of the printed catalog which appellee distributed to the trade (wholesale supply houses) there was conspicuously displayed in large type on a red background the trade name for its product "Moroloy Connecting Rods". [Pltf's Ex. 49; R. 171.] On the second and third pages of appellee's 1933 catalog [Pltf's Ex. 49] the following statements, among others, appear: "By our exclusive manufacturing practice, developed for 1933 conditions. . . . Jobbers Now Reduce Inventories 50% on These Numbers * * *

Moroloy Connecting Rods Are Centrifugally Bonded and Automatically Machined to Duplicate Original Equipment

Casting

Moroloy Centrifugally Processed Rods meet engineering specifications of original car and motor manufacturers.

This process deposits babbitt on the tinned surface under extreme centrifugal pressure, assuring an absolute bond between babbitt and steel, that is not obtainable by the old fashioned hand poured method.

Centrifugally processed connecting rods are endorsed by the Society of Automotive Engineers and are used exclusively by the following manufacturers: [naming 25 automobile manufacturers].

"If It's Not Centrifugally Cast—It's Not A Factory Duplicate

Automatic Pyrometers

To regulate the temperature of rods, tin and babbitt, the Moroloy Centrifugal Process eliminates human element entirely. Heat control is obtained by approved automatic pyrometers.

Machining and Finishing

Moroloy machining and finishing is accomplished with the same engineering exactness, following closely the recommendations and usages of leading original manufacturers.

Modern high compression engines demand close tolerances, both in bearing diameter and width. Of equal importance is proper length spacing. Moroloy precision tools are automatic in maintaining exact

length dimensions between center of piston pin and center of crankshaft.

Moroloy processed rods are straightened, cleaned and serviced with new bolts, nuts, shims and piston pin bushings. Oil clearance allowed. No scraping nor reaming required.

Electrical alignment is an exclusive Moroloy feature.

For Quick, Simple and Proper Installation,
Insist on Moroloy

The extra quality built into every rod means longer life, trouble free operation and OWNER SATISFACTION, the factors most important in building your business.

SERVICE

Fifteen manufacturing plants, located at strategic points over the United States and Canada, render a coast to coast service, convenient to every jobbing center. Ample stocks at all branches assure same day shipment. Telephone and telegraphic orders receive instant attention.

For the period June 21, 1932, to August 1, 1935, the Commissioner of Internal Revenue assessed against appellee $6,800.59 as manufacturer's excise tax under Section 606(c) of the Revenue Act of 1932, with respect to sales to jobbers of Moroloy connecting rods. [R. 45.] Appellee paid thereon to the Collector of Internal Revenue only the total sum of $1,500 in three installments of $500 each, on September 1, 1937, April 22, 1938, and August 13, 1938, respectively. [R. 44, 49-50, 55.] The $5,300.59

balance of the assessment remained unpaid and appellant set up a counterclaim therefor [R. 28-29] which the court denied. [R. 62.] Appellee filed separate claims for the refund of each of the three $500 payments [R. 45-49, 50-54, 55-58] on the grounds that it "is engaged in the business of rebabbitting worn automobile connecting rods" and that its "process is only a repair" [R. 46], and that it is not a manufacturer. The claims were rejected by the Commissioner of Internal Revenue [R. 49, 54, 58, 233-234] and this suit was timely commenced.

Statement of Points to Be Urged.

The main point upon which appellant relies [R. 255] is that the District Court erred in determining that the sales of connecting rods by appellee, during the taxable period involved herein, were not sales of automobile parts or accessories by a manufacturer or producer thereof within the purview of Section 606(c) of the Revenue Act of 1932. Included as part and parcel of the reasons for the making of this error are the following more specific points:

(a) The court erred in finding (Fdg. III) that all of the connecting rods in respect of the sale of which the tax in question was assessed were manufactured by persons, firms, or corporations other than appellee and, before their acquisition by appellee, had been used as operating parts for automobile motors, for the reason that the finding is clearly erroneous and unsupported by the evidence.

(b) The court erred in finding (Fdg. IV) that none of the articles sold by appellee, on which the tax in suit was assessed and paid, were manufactured or produced by appellee, and that appellee was engaged in the business of repairing and rebabbitting worn and damaged automobile connecting rods, for the reason that this alleged finding, if it is such is clearly erroneous and without support in the evidence. Although purporting to be a finding of fact, appellant claims it constitutes a conclusion of law or, at best, involves a mixed question of fact and law.

(c) The court erred in making a finding (Fdg. IV) that appellee's process "did not change the identity of the parts in any manner", for the reason that such finding, if material, is clearly erroneous and without support in the evidence.

(d) The court erred in failing to find that the sales by appellee were of automobile parts or accessories.

Summary of Argument.

The transactions involved constituted sales of automobile parts within the meaning of the statute, which is a revenue measure exclusively and is to be construed accordingly. The automobile parts involved were fashioned by combining new materials with salvaged materials and subjecting them to machine and hand operations which clearly constituted manufacturing and/or production processes. The completed articles were stocked, cartoned, labelled, numbered, catalogued and marketed by appellee under its own copyrighted trade name "Moroloy" and were

sold chiefly to jobbers for resale to garage men and mechanics for use in repairing automobile motors for individual car owners. From the standpoint of production and distribution in the trade, appellee performed the function of a manufacturer or producer of automobile connecting rods in the true sense, and not the repairing of used or worn connecting rods for owners or users.

The better reasoned and recent decisions, including the decision of this Court in the *Armature Exchange* case,[4] support the view that appellee is a manufacturer or producer of automobile parts within the meaning of the taxing statute. Likewise, under the applicable Treasury Regulations which have been in effect for a long period of time, during which the statute has been reenacted many times without material change, appellee is taxable as the producer or manufacturer of the articles it sold.

The judgment, ultimate findings and conclusions of the court below are not supported by the evidence, are clearly erroneous and should be reversed with a direction that judgment be entered in favor of appellant for the balance of the unpaid assessment, only $1,500 of which was paid and forms the basis for this suit.

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[4]*United States v. Armature Exchange,* 116 F. (2d) 969, certiorari denied May 5, 1941.

ARGUMENT.

I.

The Transactions Involved Constituted Sales of Automobile Parts Within the Meaning of the Statute, Which Is a Revenue Measure Exclusively, and Is to Be Construed Accordingly.

By Section 606(c) of the Revenue Act of 1932 [Appendix, *infra*], an excise tax equivalent to 2% of the sales price is imposed with respect to automobile parts or accessories on the manufacturer, producer, or importer thereof. No imports are involved here.

Clearly, the Moroloy Connecting Rods involved are automobile parts or accessories. No argument seriously can be advanced to the contrary. It is equally clear that the Moroloy rods were *sold* by appellee and were not the subject matter of contracts of *repair* for others. No contention was made by appellee to the effect that the transactions did not involve *sales* of connecting rods. The complaint affirmatively alleges [R. 3] that the taxes sued for were assessed and imposed in respect of *sales* by appellee, and the court expressly found that the taxes were assessed and imposed in respect of *sales* of connecting rods by appellee. [R. 39.] The court also found [R. 59] that the tax involved was not included by appellee in the *sale price* of the connecting rods.

Thus, under the pleadings, undisputed evidence, and findings, there can be no doubt that the transactions which were taxed constituted *sales* of automobile parts as distinguished from transactions involving repair jobs upon

articles belonging to others who retained the title thereto and who received the return thereof after the furnishing of materials and the performance of labor thereupon by appellee.

No question was raised by appellee in its claims for refund or pleadings concerning the propriety of whatever price basis was used in the computation of the total tax assessment of $6,800.59 of which only $1,500 was paid on account. The evidence does not disclose whether the outright price, consisting of part cash plus the amount of allowance made for the used article taken in trade as part payment, or merely the cash portion of the sales price which appellee contends represented the cost of the alleged "rebabbitting" or "repairing" was used in computing the tax in dispute.

It follows that the inquiry resolves itself solely into the question of whether appellee's sales of the Moroloy connecting rods for automobiles were taxable to it as the manufacturer or producer thereof within the meaning of the Act. The court reached its decision against the Government by pyramiding one erroneous view upon another; first, it assumed and concluded that the characterization *"rebabbitting"* was truly descriptive of the processes of appellee; second, that the *"rebabbitting"* process by appellee constituted a process which was one of repair only and, third, having reached the latter conclusion, it necessarily followed (irrespective of appellee's position in the trade from the standpoint of production and distribution) that it could not be a manufacturer or producer. In

reaching its decision, the District Court obviously was influenced by the fact that competitors of appellee engaged in similar business had been held by some of the District Courts, in similar fact situations, not to be manufacturers. In this connection, the trial court, in its memorandum opinion, stated [R. 34-35]:

> For the sake of uniformity, if for no other reason, taxpayers identically situated and doing precisely the same thing in relation to tax laws should be treated alike. Our inquiries and investigations have failed to disclose that the government has taken appeal in the cases referred to, and we are therefore justified in assuming that refunds have been made to the respective taxpayers situated as is the plaintiff taxpayer in this action.
>
> We are not unmindful of the decision of the Seventh Circuit Court of Appeals in *Clawson & Bals, Inc., v. Harrison, Collector,* 108 F. 2d 991, reaching a contrary conclusion as to the meaning of the terms "manufacturer" and "producer" *as applied to rebabbitting activities similar to those shown by the record before us.* * * *
>
> * * * * * * * *
>
> Inasmuch as our Circuit Court of Appeals has not considered or decided the question under consideration in this action, we are justified in formulating and reaching our own conclusions under the record before us and in the light of other identical situations considered and determined uniformly by the federal courts of the Ninth Circuit. (Italics supplied.)

We submit that the decision below is clearly erroneous. However, it is apparent from the foregoing excerpts that the District Court followed the decision in a similar type of case in the Northern District of California chiefly for

the sake of uniformity in the absence of a decision by this Court. It did not have the benefit of this Court's opinion rendered eight months later in *United States v. Armature Exchange,* 116 F. (2d) 969, certiorari denied May 5, 1941. Had the *Armature Exchange* case been decided by this Court prior to the decision below, it is safe to assume that the District Court would have reached a different conclusion, particularly in view of its expression that the record here presents "rebabbitting activities similar" to those in the case of *Clawson & Bals v. Harrison,* 108 F. (2d) 991 (C. C. A. 7th), certiorari denied, 309 U. S. 685. The latter case was cited and followed by this Court in the *Armature Exchange* case.

We make the same contention here as was made before this Court in the *Armature Exchange* case, *supra,* and in our brief in *United States of America, Appellant v. Moroloy Bearing Service of Oakland, Ltd., Appellee,* No. 9786, this Court, and in *Clawson & Bals v. Harrison, supra,* involving sales of alleged "rebabbitted" connecting rods, namely, that appellee was engaged in the manufacture and/or production and sale of connecting rods and not in the business of repairing used, discarded and worn-out connecting rods; that it had factories, made connecting rods, and sold them—it did not enter into contracts for the performance of labor and supplying of material with respect to articles owned by others who retained ownership and sought merely to prolong the life thereof by having the articles repaired for their own use; that in connection with the production of its article, appellee purchased used and worn-out connecting rods which had been discarded and relegated to the junk heap, *i. e.,* it used in part scrap having a value essentially as raw material; that it stripped and dismantled the used and dis-

carded connecting rods and salvaged and prepared the usable shanks and caps for its manufacturing and production processes; that by machine and hand operations, cleaning, cutting, grinding, grooving, polishing, manipulating, assembling, heating, chemically treating, adding and combining with the prepared salvaged parts new materials and industry, it processed and fashioned such materials into articles of merchandise which it stocked and marketed under its special copyrighted trade name "Moroloy"; that all of such articles were the equivalent of connecting rods processed, fashioned and fabricated entirely from materials which previously had not been utilized in similar manufactured articles. In other words, we contend that all of the essential elements of manufacture and/or production exist for the purpose of the taxing statute.

The statute is very broad and comprehensive and indicates a Congressional intent to bring within its reach all persons placing automobile parts and accessories on the market for sale in the United States.

An example of the broad scope of the taxing provisions, as intended by Congress, is furnished by Section 623 of the Revenue Act of 1932, which provides:

> SEC. 623. SALES BY OTHERS THAN MANUFACTURER, PRODUCER, OR IMPORTER.
>
> In case any person acquires from the manufacturer, producer, or importer of an article, *by operation of law or as a result of any transaction not taxable under this title,* the right to sell such article, the sale of such article by such person shall be taxable under this title as if made by the manufacturer, producer, or importer, and such person shall be liable for the tax. (Italics supplied.)

The applicable Treasury Regulations (Regulations 46) broadly define the terms used in the Act. They provide in part as follows:

> ART. 4. *Who is a manufacturer or producer.*— As used in the Act, the term "producer" *includes* a person who produces a taxable article by processing, manipulating, or changing the form of an article, *or produces a taxable article by combining or assembling two or more articles.*
>
> Under certain circumstances, as where a person manufactures or produces a taxable article for a person who furnishes materials and retains title thereto, the person for whom the taxable article is manufactured or produced, and not the person who actually manufactures or produces it, will be considered the manufacturer. (Italics supplied.)
>
> ART. 41. *Definition of parts or accessories.*— The term "parts or accessories" for an automobile truck or other automobile chassis or body, or motorcycle, includes (a) any article the primary use of which is to improve, repair, replace, or serve as a component part of such vehicle or article * * *.

Section 1111(b) of the Revenue Act of 1932 provides that the term *"includes"*, when used in a definition in the Act, shall not be deemed to exclude other things otherwise within the meaning of the term defined, and Article 2 of Treasury Regulations 46 provides that the "terms used in these regulations have the meaning assigned to them by section 1111".

Thus, it was obvious that Congress intended to impose the tax upon the sale of each and every automobile part or accessory produced and sold to wholesalers, jobbers and distributors, as well as sales by the producer or manu-

facturer directly to the retailer or ultimate consumer. However, the decision below, if allowed to stand, would nullify such Congressional intent by permitting the production of automobile parts from a combination of new materials with salvaged parts of worn-out articles having no other value than that of junk, and the sale thereof in competition with similar automobile parts produced entirely from new materials, without being subjected to tax upon sale to the wholesale trade.

Our contention is consistent with the definition of a manufacturer or producer as used in the Treasury Regulations which have been in effect for a long period of years, during which time the statute has several times been reenacted without change, so far as here material. Article 4, *supra,* of Treasury Regulations 46, provides that a producer includes a person who "produces a taxable article by combining or assembling two or more articles". Although this definition seemed amply clear, it has been made even clearer by Section 316.4 of the 1940 Edition of Treasury Regulations 46 which were promulgated under Section 3450 of the Internal Revenue Code with respect to excise tax provisions covering automobile parts, tires, tubes, and other taxable articles. (See Section 3400, *et seq.*. Internal Revenue Code.) Section 316.4, *supra,* provides:

> *Who is a manufacturer.*—The term "manufacturer" includes a person who produces a taxable article from scrap, salvage, or junk material, as well as from new or raw material, (1) by processing, manipulating, or changing the form of an article, or (2) by combining or assembling two or more articles.

The decisions of this Court in the *Armature Exchange* case, *supra,* and of the Seventh Circuit Court of Appeals

in the *Clawson & Bals* case, *supra,* are squarely in point and accord with the views and reasoning hereinabove expressed.

It should be remembered that the excise tax is a revenue measure exclusively. Thus, the facts must be considered in the light of such statutory object and purpose.

The tax is on each transaction at the rate of 2% of the manufacturer's or producer's sale price of the article sold. It is not imposed upon repair jobs[5] involving mere contracts for labor and material with respect to articles owned and used by another. Yet, despite the undeniable fact that appellee realized its business profit from the sale of its product, the court below erroneously concluded [R. 39-40] that appellee was "engaged in the business of repairing and rebabbitting worn and damaged automobile connecting rods". An effective answer to this conclusion or finding was furnished, we believe, by the Seventh Circuit Court of Appeals in *Clawson & Bals v. Harrison,* 108 F. (2d) 991, 994, wherein it said:

> The fact that the taxpayer could perform for the owner of used connecting rods all of the mechanical operations which it does perform under the facts of this case, and still properly be classified as a repairer, does not require a holding that the taxpayer is a repairer when it purchases discarded rods to be used as materials for combination with other materials of the taxpayer, and by means of mechanical operations prepares what are, for all practical purposes, new connecting rods for sale in the trade.

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[5]As a matter of administrative policy, the revenue officials eliminate from their excise tax computations all repair job transactions, if any, which may be found, or which the taxpayer may have overlooked.

Because of the hundreds of thousands of transactions occurring daily throughout the country, which are subject to the excise tax provisions, the method of ascertainment of such taxes must be possible of accomplishment without being fettered by technical refinements which tend to defeat the purpose of the statute as a means of raising revenue. The following quotation from *Raybestos-Manhattan Co. v. United States,* 296 U. S. 60, 63, is apropos here:

> The reach of a taxing act whose purpose is as obvious as the present is not to be restricted by technical refinements.

See, also:

> *Founders General Co. v. Hoey,* 300 U. S. 268, to the same effect.

In *Tyler v. United States,* 281 U. S. 497, the Court stated (p. 503):

> The power of taxation is a fundamental and imperious necessity of all government, not to be restricted by mere legal fiction * * *.
>
> Taxation, as it many times has been said, is eminently practical * * *.

In the *Tyler* case the Court held that the Congressional intent to tax decedent's interest at date of death in a tenancy by the entireties could not be restricted by the technical incidents of such common law tenancy. Likewise, the terms "manufacturer" or "producer", used in the statute, should not be treated as words of art, but rather construed so as to effectuate the evident broad intent

of Congress with respect to the taxation of automobile parts. In *Turner v. Quincy Market Cold Storage & Warehouse Co.,* 225 Fed. 41, 43 (C. C. A. 1st), it was held that the term manufacture "is a very broad word, which it is not safe to limit in a general way". See *Hughes & Co. v. City of Lexington,* 211 Ky. 596, 277 S. W. 981, 982, wherein the court, in holding that appellant was engaged in manufacturing, stated:

> That the definition of the term is a question of law and for the courts is plain, but the courts are practically agreed that it is incapable of exact definition, and that there is no hard and fast rule which can be applied, but that *each case must turn upon its own facts, having regard for the sense in which the term is used and the purpose to be accomplished.* [Citing cases.] (Italics supplied.)

In *Carbon Steel Co. v. Lewellyn,* 251 U. S. 501, it was held that the rule of strict construction will not be pressed so far as to reduce the taxing statute to a practical nullity by permitting easy evasion. The court stated (p. 505):

> It is, of course, the contention of petitioner that this was furnishing, not *manufacturing,* and that the literal meaning of words can be insisted on in resistance to a taxing statute. We recognize the rule of construction but it cannot be carried to reduce the statute to empty declarations. And, as we have already said, petitioner's contention would so reduce it.

It may be added that the proper guide for the interpretation and construction of Section 606(c)—as for all internal revenue laws—was furnished by the Supreme Court in *Stone v. White,* 301 U. S. 532, 537:

> It is in the public interest that no one should be permitted to avoid his just share of the tax burden except by positive command of law, which is lacking here.

It follows from what has been said that the first question for determination in a case of this kind is whether there has been a *sale* of the articles under consideration, for if there has been no sale the statute does not apply. If the articles have been sold, the only remaining inquiry is whether the seller was also the manufacturer, producer, or importer thereof, within the meaning of the applicable statute and regulations. In passing upon the latter question, it should be borne in mind that the idea of one repairing an article for another is opposed to the idea that the repairer may be simultaneously the seller of the article itself upon completion of his contract for the performance of labor and supplying of materials. Yet, conversely, the appellee contends in substance that although it was the seller of the articles in question, it should be held to be only the repairer thereof. There is no question but that the "MOROLOY" Connecting Rods were sold by appellee for use by ultimate vendees in repairing automobile engines.

II.

Appellee Is the Manufacturer or Producer of the Moroloy Connecting Rods Sold by it and Not Merely a Repairer of Second-hand, Damaged and Worn Out Connecting Rods.

Appellee was incorporated for the defined purpose of operating a "business for the manufacture, sale and distribution of automotive * * * products" and to "operate branch plants" therefor. [R. 37.] It actually engaged in the business of selling automobile parts to automotive jobbers throughout the United States and, through an affiliate, in Canada. It operated six plants or factories, had considerable machinery and equipment for its operations, produced an estimated amount of more than 240,000 connecting rods each year, maintained a stock for sale of connecting rods for nearly all makes of automobiles, and cartoned or boxed each article in a container marked with appellee's own trade name and stock number. In its printed trade catalogs, it unmistakably represented its function and processes as those of a manufacturer.

The taxing statute does not discriminate between automobile parts produced entirely from new materials and those produced by combining new materials with usable materials salvaged from discarded articles, scrap or junk purchased and dismantled for such purpose. Neither do the definitions of the words manufacturer, producer, manufacture, or produce, require that a manufactured article shall consist entirely of new or virgin raw materials. In fact, it has been held that a manufactured article need

not be made wholly or even in part of raw material. (*The King v. Biltrite Tire Co.,* 1937 Canada Law Rep. (Ex. C. R.) 1, 14.)

In the *Armature Exchange* case, *supra,* this Court stated (p. 971):

> We cannot find any justification for reading into the statute involved here, as taxpayer would have us do, the qualification that the articles "manufactured or produced" must have been so manufactured or produced entirely from new or virgin raw materials.
> * * *
>
> The Government contends, and we think correctly, that the discarded armatures purchased by the taxpayer, having lost their function as a useful article as well as their commercial value as such, when acquired for use in the manufacturing and production of an article of commerce, bear the same relation to the completed armature as the purchase of unused materials would bear to the completed article. See *Cadwalader v. Jessup & Moore Paper Co.,* 149 U. S. 350 * * *. The article resulting from the use of the discarded core with new materials, and through the employment of skill, labor and machinery, is, as it seems to us, a manufactured and produced article of commerce. Such an article produced in quantities under a trade name and placed in stock for future sale must be classified as a manufactured or produced article. It is our opinion and we hold that these operations constituted "manufacture or production" within the meaning of the statute involved. See opinion in *Clawson & Bals, Inc. v. Harrison,* 7 Cir., 108 Fed. (2d) 991.

The use of the term "rebabbitted" is without material significance, for it appears to have been acquired in the early days of the automotive industry and obviously was borrowed from the garage man or mechanic who originally used to "rebabbitt" the connecting rods of an owner who brought in his car for repairs. [R. 85.] Appellee's function, and that of its competitors, has not only supplanted the former limited undertaking of the individual mechanic but, by a process of industrial evolution, both mechanically and economically, has become an integral part of the automotive replacement parts manufacturing industry, so much so that today all the mechanic need do is purchase a new set of connecting rods at reasonable cost from the nearest parts jobber and install them, instead of attempting to repair the babbitt bearings of his customer's connecting rods. [R. 85.]

Appellee obviously considered itself the producer of the connecting rods it stocked and sold, otherwise it is not likely that it would have adopted the trade name under which it advertised and catalogued its product. The rods were placed by appellee in marketable or merchantable form with the usual standard guarantee for such articles.

The court below, as stated in its opinion, considered that the socalled "rebabbitting" activities of appellee, as shown by the record before us, were similar to those considered by the Seventh Circuit Court of Appeals in the *Clawson & Bals* case, *supra*. Appellee's chief witness testified [R. 196-197] that appellee handled its customers

in the same way as did most "rebabbitters", including the Federal Mogul Corporation, which is one of the largest in the United States.

In view of the information contained in the *Federal Mogul*[6] and *Clawson & Bals* findings and decisions, this Court will take notice of the fact that the loosely used trade characterization "rebabbitted" does not furnish an accurate or complete description of the processes undertaken by persons who sell articles of the disputed type to wholesale automotive jobbers. Consequently, and in view also of the evidence in this case, we submit that the court below erroneously held [R. 39] that the connecting rods (which were sold by appellee) were manufactured by others. In view of the processes disclosed by the evidence, it is not possible correctly to so find. The court might have found that the caps and shanks and some of the nuts and bolts used in appellee's processes originally had been made by others but such a finding would not detract from our contention herein.

Likewise, the court erred in finding that the used connecting rods sold by appellee formerly had been used as operating parts for automobile motors. Appellee did not sell formerly used connecting rods but sold a product which it assembled from materials salvaged from formerly used connecting rods and other materials. As disclosed by the evidence here and by the finding in the *Federal*

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[6]*Federal Mogul Corp. v. Smith* (S. D. Ind.), decided February 23, 1940, not officially reported but published in 1940 Prentice-Hall, Vol. 4, par. 62,510.

Mogul and *Clawson & Bals* cases, *supra,* the babbitting process is not the chief operation in the production of connecting rods. This is particularly true where the rods are equipped with bronze bushings. In such cases the bronze bearing and babbitt bearing, as stated, are equally important and, in addition, there is the requirement of shims and new nuts and bolts so that the only used materials involved in such a rod may consist merely of formerly used cap and shank.

Although appellee's witness Morris testified that the same cap was put back on the same shank, it appears from the *Federal Mogul* findings that it is not necessary to do this in all cases. This is especially true in the case of Ford rods. Thus, it frequently may occur that upon completion of a rod it may contain a cap from one formerly used rod, a shank from another used rod, and the balance thereof entirely of new materials.

Appellee's own evidence refutes the idea that it merely "rebabbitted" connecting rods for others. In its printed catalog (Pltf's. Ex. 49), it represented that Moroloy processed rods contained "new bolts, nuts, shims and piston pin bushings". Consequently, the Moroloy rods which were sold by appellee were not rods originally manufactured by others than appellee, or rods which previously had been used as operating parts of automobile motors, as found by the court. As stated, these findings clearly are erroneous.

We believe that the foregoing discussion aptly demonstrates that appellee did not sell what were in fact "re-

babbitted" connecting rods but sold to the trade connecting rods which it fashioned, assembled and processed from commingled scrap and new materials.

The evidence definitely established that appellee was the producer of the connecting rods it sold because the essential elements of manufacture or production were shown to exist. It acquired worn-out connecting rods which it dismantled and from which it salvaged the usable parts and then, by machine and hand operations, together with the addition of new materials, it assembled and fashioned an automobile part which it marketed under its own trade name in competition with similar products manufactured by the Federal Mogul Corporation, Clawson & Bals, Inc., automobile manufacturers and others. It made a serviceable and salable product from scrap and raw materials. Whether appellee itself manufactured the shank and cap used in producing Moroloy connecting rods would appear to be immaterial. The essential fact is that appellee combined the salvaged individually useless items with new materials and, through the employment of skill, labor, and machinery, produced a valuable item of commerce which it sold to the trade. Thus, from the standpoint of production and distribution in the trade, appellee performed the function of a producer or manufacturer rather than a repairer.

III.

The Applicable Decisions Support the Contention That Appellee Is a Manufacturer or Producer of Automobile Parts Within the Purview of the Taxing Statute.

The Government's position that persons engaged in selling automobile parts processed by them from a combination of usable parts (salvaged and prepared from dismantled formerly used parts) and new materials are producers and/or manufacturers of automobile parts and accessories within the meaning of the taxing statute is supported by the following decisions:

United States v. Armature Exchange, decided by this Court, involving automobile generator armatures processed from a combination of new and used materials. The taxpayer sold its armatures in boxes bearing the legend "Armex Rebuilt Armatures". 116 F. (2d) 969, 970, certiorari denied May 5, 1941.

Clawson & Bals v. Harrison, 108 F. (2d) 991 (C. C. A. 7th), certiorari denied, 309 U. S. 685, involving alleged "rebabbitted" connecting rods made by taxpayer from a combination of used caps, shanks, nuts and bolts and new materials.

Edelman & Co. v. Harrison (N. D. Ill.), decided April 7, 1939, not officially reported but published in 1939 Prentice-Hall, Vol. 1, par. 5.379, involving so-called "rewound" armatures and "rebuilt" generators for automobiles made by taxpayer from a combination of new and used materials.

Federal-Mogul Corp. v. Smith (S. D. Ind.), decided February 23, 1940, not officially reported but published in 1940 Prentice-Hall, Vol. 4, par. 62,510, involving automobile connecting rods made by taxpayer from a combination of new and used materials in a manner similar to that involved in the *Clawson & Bals* case, *supra,* and the instant case.

Moore Bros., Inc. v. United States (N. D. Tex.), decided May 14, 1940, not officially reported but published in 1940 Prentice-Hall, Vol. 4, par. 62,676, involving so-called "rebuilt" automobile armatures.

The case of *Motor Mart v. United States* (N. D. Tex.), (involving generators and armatures) was decided for the Government on May 14, 1940, without opinion (Civil Action #239).

Biltrite Tire Co. v. The King, 1937 Canada Law Rep. 364, arising under the Canadian War Revenue Act of 1927, involving language similar to that used in Section 606(c) of the United States Revenue Act of 1932, and involving so-called "retreaded" automobile tires.

The King v. Biltrite Tire Co., 1937 Canada Law Rep. 1, being the immediately preceding case in the Exchequer Court of Canada, at first instance and in the exercise of its appellate jurisdiction.

The King v. Boultbee, Ltd. [1938], 3 Dominion Law Rep. 664, involving so-called "retreaded" automobile tires made by taxpayer on a small scale. Taxpayer also did considerable retreading of tires for customers to whom the tires were returned. The latter transactions were not sought to be taxed because they did not involve a sale of the completed article but merely a contract for the furnishing of materials and labor.

In *Foss-Hughes Co. v. Lederer* (E. D. Pa.), 287 Fed. 150, an assembler of truck parts was held to be taxable as a producer of trucks within the meaning of the excise tax law of October 3, 1917. The law provided for a tax on automobile trucks sold by the manufacturer, producer, or importer. The taxpayer was a dealer who neither imported nor manufactured but purchased the chassis from the manufacturer and then employed a contractor to add the body. He was held liable as a producer of trucks in these circumstances. In this case, the court, apparently recognized that the term "producer" is broader than the term "manufacturer".

In *Klepper v. Carter,* 286 Fed. 370, 371, this Court cited and relied upon the *Foss-Hughes* case, *supra.* In the *Klepper* case this Court held a retail salesman liable under the 1919 version of the 1932 excise tax law as a manufacturer or producer of automobile trucks. The salesman merely purchased automobile truck bodies from one manufacturer and chasses from another, and assembled the two parts. The Court directed attention to the fact that Article 7 of the December, 1920, revision of the Regulations defined the word "manufacturer" as generally a person who (1) actually makes a taxable article; or (2) by changes in the form of an article produces a taxable article; or (3) *by the combination of two or more articles produces a taxable article.* This Court said that the retail salesman, Klepper, saved the purchaser all the trouble of assembling the chassis and body, and made it his business to retail the product of his purchases as an automobile truck that he thus produced or manufactured the truck.

In *Cadwalader v. Jessup & Moore Paper Co.,* 149 U. S. 350, the recovery of customs duties was sought on the

ground that old india-rubber shoes imported by Jessup and Moore were valuable only as a substitute for crude rubber and, therefore, were exempt from duty under the free classification "India-rubber, crude and milk of". A duty of twenty-five per cent *ad valorem* had been collected on the old shoes as (p. 351) "articles composed of india-rubber, not specially enumerated or provided for in this act". Another section of the act provided for a duty on non-enumerated articles equal to that imposed upon the enumerated articles they most nearly resembled, and where they resembled two or more enumerated articles, that taking the highest duty was to be used as the basis. The Supreme Court, in holding the articles to be non-dutiable, held that the old shoes had lost their commercial value as such articles, and substantially were merely the material called "crude rubber". Thus, the principle of the *Cadwalader* case supports the contention that a taxpayer engaged in the production of automobile parts in the manner herein disclosed is a manufacturer and producer since, because of the loss of their commercial value, the used connecting rods are essentially raw material.

Although we contend that the patent infringement decisions and some of the tariff cases are not in point, the two following cases are of interest:

In *Cotton Tie Co. v. Simmons*, 106 U. S. 89, the Court held that one who bought used cotton-bale ties, consisting of a metal buckle and a band, which were patented, and who rolled and straightened the pieces of the ties, riveted the ends together, and cut them into proper lengths and sold them with the buckles to be used again as ties, had "reconstructed" and not merely "repaired" the bale-ties in the patent law sense and was guilty of

infringement even though no new material parts were added.

In *Davis Electrical Works v. Edison Elec. Light Co.,* 60 Fed. 276 (C. C. A. 1st), the court held that the making of a hole in the bulb of an Edison incandescent lamp, in which the filament has been destroyed by use, and the putting in of a new filament and closing the hole by fusing a piece of glass over it and then exhausting the air, constituted "reconstruction" and not merely repairing as matter of patent law.

There can be no dispute but that when appellee acquired the used and worn-out automobile parts, they were classifiable as scrap and junk. The following definitions and authorities concerning scrap and junk seem clearly applicable:

56 *Corpus Juris.,* 884-885, states:

> *Scrap.* (Sec. 1)A. *As Noun.* The word originally meant what was scraped off. It has come to have an extended meaning and includes anything that is thrown aside. The word has reference to the antecedent history of the article and not to the use that a new owner might make of it.
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> * * * * * * * * *
>
> (Sec. 2)B. *As Adjective.* On the form of scraps; also valuable only as raw material.

In *Ward, Ltd. v. Midland R. Co.,* 33 T. L. R. 4, 6 (Eng.), "scrap" was defined as follows:

> An article was scrap if it was no longer useful to its owner; the word had reference to the antecedent history of the article and not to the use that a new owner might make of it.

The word "junk" has been held to include discarded parts of machinery. *City of Duluth v. Bloom,* 55 Minn. 97, 100, 21 L. R. A. 689, 690. Discarded automobile fixtures were held to be within the definition of "junk" in *Melnick v. City of Atlanta,* 147 Ga. 525, 94 S. E. 1015. In *City of Chicago v. Reinschreiber,* 121 Ill. App. 114, 120, the court defined the word "junk" as (pp. 118-119)—

> worn out or discarded material in general, that still may be turned to some use, especially old rope, chain, iron, copper, parts of machinery, bottles, etc., gathered or bought up by persons called "junk dealers" * * *.

In the instant case, the used parts were nothing more than "junk" when received by appellee. The principal purpose of its business was to produce and sell automobile connecting rods for numerous makes of automobiles from a combination of new or prepared raw materials and essentially raw material which appellee prepared. The acquisition of second-hand material was merely incidental to its production and/or manufacturing business.

In *City of Louisville v. Zinmeister & Sons,* 188 Ky. 570, 222 S. W. 958, the court stated (pp. 575-576):

> Courts here experienced much difficulty in determining what is a manufacturing establishment and what is included in the term "manufacture." There is no hard and fast rule by which to determine whether a given establishment is a "manufactory," but *all the facts and circumstances must be taken into consideration* in determining whether the establishment is or is not to be so reckoned. *Whether it is such an establishment does not depend upon the size of the plant, the number of men employed, the nature of the business or the article to be manufactured, but upon all these together and upon the result accomplished.*

> If raw material is converted at a factory or plant into a finished product, complete and ready for the final use for which it is intended, or so completed as that in the ordinary course of business of the concern it is ready to be put upon the open market for sale to any person wishing to buy it, the plant which turns it out is a manufacturing establishment within the meaning of the statute * * *. (Italics supplied.)

Likewise, in the instant case it is important to consider all the surrounding facts and circumstances and not limit consideration of the question involved to any single factor, or to the narrow confines of an antiquated literal interpretation of the word "manufacture" as understood prior to the advent of modern machinery and industrial methods of salvaging for manufacturing purposes.

If the terms "manufacturer" and "producer" are to be whittled away by fine distinctions, the intent and purpose of Congress to impose a tax upon automobile parts produced and sold to jobbers and wholesalers will necessarily be defeated. *In re First Nat. Bank,* 152 Fed. 64, 67 (C. C. A. 8th).

If appellee had imported used connecting rods and done nothing whatsoever to them and then had sold them, it would have incurred an excise tax under the statute in question as an "importer".

In addition to the foregoing decisions, it may be noted that the taxpayers in the following cases voluntarily dismissed their refund actions after the action of the Seventh Circuit Court of Appeals in the *Clawson & Bals* case, *supra*:

S. & R. Grinding & Machine Co. v. United States (W. D. Pa.) (involving connecting rods), voluntarily dismissed on plaintiff's motion, despite the fact it earlier had obtained a favorable ruling on the Government's motion to dismiss. The ruling on the motion to dismiss is reported in 27 F. Supp. 429.

Federal-Mogul Corp. v. Kavanagh (E. D. Mich.) (involving connecting rods), voluntarily dismissed by taxpayer as the parties were about to proceed to trial.

The foregoing Canadian decisions[7] are particularly applicable because they involved a consideration of contentions similar to those advanced herein by appellee, under a revenue statute containing similar provisions. The taxpayer there contended that the old tires had not lost their identities as such during the "retreading" operations, that the names and numbers of the original manufacturers were not marred or obliterated, and that the taxpayer was merely the repairer of second-hand tires and not the manufacturer or producer thereof. However, each of the contentions was rejected by the Supreme Court of Canada and the Exchequer Court on reasoning similar to that followed by the American decisions upon which we rely.

It cannot be disputed that the used rods had lost their commercial value as connecting rods and, after the dismantling thereof, the salvaging of the usable forgings

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[7] *Biltrite Tire Co. v. The King*, 1937 Canada Law Rep. 364; *The King v. Biltrite Tire Co.*, 1937 Canada Law Rep. 1.

therefrom and the preparation of the forgings for taxpayer's operations, there remained prepared materials for manufacturing processes. Such prepared materials were not then connecting rods but mere forgings on which appellee thereafter performed grinding operations, machining operations, added other materials, assembled the same and employed skill before completing its marketable product and placing it in stock for sale to wholesalers. The position of appellee is the same as if it had purchased forgings salvaged (from old or worn-out articles) and prepared by the vendor for babbitting, bushing, machining, assembling and finishing operations. If then appellee had purchased from a third party the remaining necessary materials, consisting of babbitt, shims, nuts, bolts and bushings, and continued with all subsequent steps, it could hardly be suggested that the article in its final condition had not been produced or manufactured by appellee. And the mere fact that appellee has itself performed the defined operations on the old forgings cannot exclude it from the operation of the taxing statute.

It is suggested that the old or worn-out rod did not lose its identity *qua* rod and that, therefore, the appellee could not be said to have manufactured or produced a rod. However, when one bears in mind the various steps taken by appellee and particularly the state of the article when the babbitt bearing, bronze bearing, bolts, nuts and shims were removed, it would appear that appellee cannot be any less the manufacturer of a connecting rod because it started with something that had once been

a usable rod than if, as suggested above, it had commenced with several substances purchased from different sources.

The following decisions, all of which are of District Courts, are against the Government. However, most of them have been, in effect, overruled by the later decisions of the Seventh Circuit Court of Appeals and of this Court, as hereinafter indicated:

Monteith Brothers Co. v. United States (N. D. Ind.), decided October, 1936, not officially reported but published in 1936 Prentice-Hall, Vol. 1, par. 1710 (involving armatures and connecting rods), overruled by the Seventh Circuit Court of Appeals in the *Clawson & Bals* case, *supra.*

Hempy-Cooper Mfg. Co. v. United States (W. D. Mo.), decided May 6, 1937, not officially reported but published in 1937 Prentice-Hall, Vol. 1, par. 1461 (involving connecting rods).

Bardet v. United States (N. D. Cal.), decided May 18, 1938, not officially reported but published in 1938 Prentice-Hall, Vol. 1, par. 5507 (involving connecting rods). This case was overruled by the decision of this Court in the *Armature Exchange* case, *supra.*

Becker-Florence Co. v. United States (W. D. Mo.), decided December 27, 1938, not officially reported but published in 1939 Prentice-Hall, Vol. 1, par. 5161 (involving armatures).

Con-Rod Exchange, Inc. v. Henricksen, 28 F. Supp. 924 (W. D. Wash.) (involving connecting rods). This

case was overruled by the decision of this Court in the *Armature Exchange* case, *supra.*

Armature Rewinding Co. v. United States (E. D. Mo.), decided September 30, 1940, not officially reported but published in 1940 Prentice-Hall, Vol. 4, par. 62,887 (involving generators and armatures). This case is now pending on the Government's appeal before the Eighth Circuit Court of Appeals.

The *Con-Rod* case, *supra,* was not appealed because both it and the *Armature Exchange* case, *supra,* were decided at about the same time by Judge Yankwich and it was deemed by the Solicitor General that the appeal in the *Armature Exchange* case would suffice, especially when a successful appeal in the *Con-Rod* case would have resulted in a judgment for considerably less than the cost of appeal. The remaining cases which were not appealed did not present satisfactory records. However, we contend that the several adverse District Court decisions were erroneous.

The case of *Hartranft v. Wiegman,* 121 U. S. 609, relied on by the court below in its opinion, is not in point. It, and other Supreme Court decisions usually urged by taxpayers in these cases, were rejected in the *Armature Exchange* case as being inapplicable.

IV.

The Government's Position Is Also Supported by the Treasury Regulations Which in the Light of the History and Reenactment of the Taxing Provisions Without Material Change Have Been Given Congressional Approval.

The Government's position is consistent with Treasury Regulations 46, 1932 Edition:

> ART. 4. *Who is a manufacturer or producer.*— As used in the Act, the term "producer" includes a person who produces a taxable article by processing, manipulating, or changing the form of an article, or produces a taxable article *by combining or assembling two or more articles.* (Italics supplied.)

Section 316.4 of Treasury Regulations 46, 1940 Edition, is to the same effect as Article 4, *supra,* except that the later Regulations are even more specific, namely:

> SEC. 316.4. *Who is a manufacturer.*—the term "manufacturer" includes a person who produces a taxable article from scrap, salvage, or junk material, as well as from new or raw material (1) by processing, manipulating, or changing the form of an article, or (2) *by combining or assembling two or more articles.* (Italics supplied.)

Article 7 of the applicable Treasury Regulations, as revised in December, 1920, defines a manufacturer as generally a person who—

> (1) actually makes a taxable article; or (2) by changes in the form of an article produces a taxable article; or (3) *by the combination of two or more articles produces a taxable article.* (Italics supplied.)

The italicized part of the 1920 revision of the Regulations was carried forward in Regulations 47, revised March, 1926, as Article 6 thereof, also in the 1921 and 1924 Regulations under the 1921 and 1924 Revenue Acts.

The same definition of manufacturer was also carried forward in Regulations 46, under the Revenue Act of 1932, as Article 4 thereof as shown above.

The following is a history of the enactment and re-enactment of the excise tax law with respect to automobile parts and accessories:

The Revenue Act of 1918, c. 18, 40 Stat. 1057, Section 900(3), was the first to impose a tax on automobile parts and accessories as distinguished from automobiles themselves which were first taxed under the 1917 Act. The rate, under the 1918 Act, on such parts and accessories was 5%. The tax was reenacted by Section 900(3) of the Revenue Act of 1921, c. 136, 42 Stat. 227, and the rate was the same, effective as of January 1, 1922.

Under Section 600(3) of the Revenue Act of 1924, c. 234, 43 Stat. 253, the tax was carried forward and the rate was reduced to 2½%.

The Revenue Act of 1926, c. 27, 44 Stat. 9, Section 600, taxed "automobile chasses and bodies and motorcycles (including tires, inner tubes, parts, and accessories therefor, sold on or in connection therewith or with the sale thereof" at 3%. Therefore, under the 1926 Act, parts and accessories sold separately were not taxed.

The Revenue Act of 1928, c. 852, 45 Stat. 791, Section 421, repealed, as of the date of its enactment, May 29, 1928, the taxes on automobiles.

By Section 606 of the Revenue Act of 1932, the tax again was placed on automobiles, parts and accessories, among other things.

The 1932 Act remained in effect during the passage of all subsequent Revenue Acts and was reenacted in the subsequent Acts or extended by resolution, and was reenacted in the Internal Revenue Code as Section 3403.

Section 3403 was amended by Section 1 of the Revenue Act of 1939, c. 247, 53 Stat. 862, and Sections 209 and 216 of the Revenue Act of 1940, c. 419, 54 Stat. 516, but was not changed so far as here material.

Section 210 of the 1940 Act amends the Internal Revenue Code by adding a new section thereto, the effect of which is to change the rate on automobile parts and accessories from 2% to 2½% for the period after June 30, 1940, and before July 1, 1945.

If, in addition to Article 4 of Treasury Regulations 46, approved June 18, 1932, providing that as used in the Act the term "producer" includes a person who produces a taxable article by combining or assembling two or more articles, more were needed, attention is directed to the fact that this provision has appeared in the Treasury Regulations since 1920, during which time the taxing statute has been reenacted several times without material change. Under the established rule Congress must be taken to have approved the administrative construction and thereby to have given it the force of law. *Helvering v. Reynolds Tobacco Co.,* 306 U. S. 110, 115; *United States v. Armature Exchange, supra.*

See, also, S. T. 896, 1940-2 Cum. Bull. 252, published February 19, 1940, to the effect that persons who manufacture or produce connecting rods from used or worn-out connecting rods and new material are manufacturers and producers within the meaning of Section 606 of the Revenue Act of 1932, and are subject to tax thereunder upon the sales of such rods.

By S. T. 896, the following earlier rulings were modified to accord with the principles laid down in the *Clawson & Bals* decision:

S. T. 606, XI-2 Cum. Bull. 476 (1932), relating to rebuilt taxi meters.

S. T. 648, XII-1 Cum. Bull. 384 (1933), and S. T. 812, XIV-1 Cum. Bull. 406 (1935), relating to retreaded and rebuilt tires.

Thus, under any view of the case, the evidence brings appellee squarely within the definition of a manufacturer or producer as set forth in the Regulations for the past twenty years, namely, that "a person who * * * produces a taxable article by combining or assembling two or more articles" is included in the term "producer" as used in the Act.

In conclusion, it is submitted that under the applicable statute, decisions, Regulations, and undisputed evidence the court below should have made ultimate findings of fact and entered judgment in favor of appellant for the amount of its counterclaim, and dismissing appellee's complaint.

Conclusion.

It is submitted that the law and undisputed evidence do not support the ultimate findings, conclusions, and judgment below. The judgment should be reversed.

Respectfully submitted,

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September 26th. 1941.

APPENDIX.

Revenue Act of 1932, c. 209, 47 Stat. 169:

SEC. 606. TAX ON AUTOMOBILES, ETC.

There is hereby imposed upon the following articles sold by the manufacturer, producer, or importer, a tax equivalent to the following percentages of the price for which so sold:

* * * * * * * * *

(c) Parts or accessories (other than tires and inner tubes) for any of the articles enumerated in subsection (a) or (b), 2 per centum. * * *

[Note: Subsections (a) and (b) refer to automobiles, automobile trucks and motorcycles.]

Treasury Regulations 46, approved June 18, 1932:

ART. 4. *Who is a manufacturer or producer.*—As used in the Act, the term "producer" includes a person who produces a taxable article by processing, manipulating, or changing the form of an article, or produces a taxable article by combining or assembling two or more articles.

Under certain circumstances, as where a person manufactures or produces a taxable article for a person who furnished materials and retains title thereto, the person for whom the taxable article is manufactured or produced, and not the person who actually manufactures or produces it, will be considered the manufacturer.

A manufacturer who sells a taxable article in a knock-down condition, but complete as to all component parts, shall be liable for the tax under Title IV and not the person who buys and assembles a taxable article from such component parts.

ART. 41. *Definition of parts or accessories.*—The term "parts or accessories" for an automobile truck or other automobile chassis or body, or motorcycle, includes (a) any article the primary use of which is to improve, repair, replace, or serve as a component part of such vehicle or article, (b) any article designed to be attached to or used in connection with such vehicle or article to add to its utility or ornamentation, or (c) any article the primary use of which is in connection with such vehicle or article whether or not essential to its operation or use.

The term "parts and accessories" shall be understood to embrace all such parts and accessories as have reached such a stage of manufacture that they constitute articles commonly or commercially known as parts and accessories regardless of the fact that fitting operations may be required in connection with installation. The term shall not be understood to embrace raw materials used in the manufacture of such articles.

Spark plugs, storage batteries, leaf springs, coils, timers, and tire chains, which are suitable for use on or in connection with, or as component parts of, automobile truck or other automobile chassis or motorcycles, are considered parts or accessories for such articles whether or not primarily designed or adopted for such use.